Bookkeeping tips to help you properly end your tax year

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Whether or not you have a bookkeeper, these are the things to check to avoid paying higher tax preparation fees than necessary and overpaying the IRS.

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Foreword

When it comes to bookkeeping, even when entrepreneurs have the expertise to comply with federal and state requirements, they'd rather do something else. One way we help entrepreneurs is to offer this free booklet to help identify places in your accounting process which need some focused attention. What are your goals in business? Attracting investors? Getting a bank loan, or increasing profits? When your books are in order, you know where you stand and you are free to pursue your goals.

Sound Bookkeepers is here for you. Our customers are satisfied because their data is clear and easy to understand. We talk to you, decide what you need, and get it done in a timely manner. We also offer a special report called Un-Funding the IRS: How to put an end to paying IRS fines and penalties. Be sure to contact us and request this special report if you want to save on your taxes.

Throughout the year, we do each of these tasks so that by Jan 31, we can give our clients their final numbers. If you have a project, are behind, or otherwise would like to talk, our initial phone consultation is free and can be scheduled directly on our website www.sbk2.co. You can also call today 206 794 3864 so we can immediately begin creating solutions for you. Let us show you exactly why our clients recognize us as the premier bookkeeping service.

Introduction

Even if you have a bookkeeper, these are the things to check to avoid paying higher tax preparation fees than necessary and overpaying the IRS.

This booklet helps entrepreneurs in two ways:

First, if you are doing the bookkeeping yourself, or you already have a bookkeeper, this checklist covers each end of the year end item which should be addressed to be certain your final profit and loss statement and balance sheet are as clean and accurate as possible. Why? So you can have lower tax return preparation fees and the best possible outcome on your total tax due to the IRS and Department of Revenue. You or your bookkeeper can check each one as you either address it, or decide it's not applicable. Checkbox and notes spaces are provided for this reason.

The 2nd way it will help you is if you have a bookkeeper, but you don't know how to tell if they are doing things right. Bookkeeping is a fiduciary activity because of its ability to make or break a person's business, but anybody can call themselves a bookkeeper in Washington with no experience or skills. If you are not sure whether your bookkeeper is qualified to be doing your books, you can use this as a test. Ask them to write up a list of all the items they check at the end of year when they are reviewing your books, then see how closely their list matches this one.

We review the books in a similar layout as the chart of accounts, assets, liabilities, equity, income, cogs, expenses. And now, here's the list…

Things to check in QuickBooks

<u>Chart of Accounts</u>

From your tax return from last year, which form did you file to report your business income and expenses? Most small businesses file a schedule C, next most common would be in 1120 S, followed by 1065 partnerships and 1120 C. This is important to ensure the categories in your chart of accounts in QuickBooks matches the categories used to claim expenses on your tax return.

The categories you attribute your expenses to are listed in your chart of accounts and should match the categories allowed on your particular tax form in the "cost of goods sold" and "expenses" sections. There may be unused categories in your chart of accounts, make these inactive. You can see what's being used by running a profit and loss report for all time. If it's not on there, then you're probably not using it.

Look through the chart of accounts to make sure the wording of the categories actually makes sense to you, and that they would also be easy for your accountant to transfer onto your tax return. Look for duplicates and things spelled incorrectly, or items with incorrect subcategories. Example: gas, wiper blades, and carwashes, would all go under auto.

Customers

Review your customer list. Are all of these people actually customers? If you are using the invoicing tools of QuickBooks, run an accounts receivable report. This should only contain current items. If there are open invoices for people you know have paid, then somewhere those payments need to be matched up with the open invoices or the invoices should be deleted.

Bank Deposits

Click in the bank deposit section to verify there are no stray transactions sitting there waiting to be matched with an already existing deposit. This is also called "undeposited funds". The only items in bank deposit should be those payments you're still holding in your pocket and have not deposited in the bank yet, or have been charged but not yet transferred to your bank account. If you've processed any refunds, there should be a refunds category in your income section. This is important so that the total amount of income minus refunds and credit card processing fees equals the total deposits into your bank account.

Assets

Does your business have any kind of assets like computers, furniture, equipment, tools or vehicles? Entrepreneurs rarely remember to get these on to the balance sheet by adding them to the chart of accounts. Some assets depreciate, so the depreciation should be tracked as well in the books. Usually your accountant provides a depreciation schedule or makes annual adjustments for what was already claimed. It's important because when dispose of or sell an asset you've been depreciating, you have to "recapture" any remainder and pay taxes on that net difference. If it's a small item, then it might need to be moved down to the expense section to be deducted all in one year rather than being listed as an asset. If you have purchased an asset but are not sure if it needs to be depreciated, ask your accountant or tax preparer where to put it. If the item's useful life is longer than a year or if it was expensive, then it potentially may need to be depreciated.

Cash Deposits

If you use the cash register at your location, and you're keeping the balance the same at the beginning of each day as is commonly done, then any branch deposit into your bank would usually equal the total of any checks received plus any cash received and would be attributable to income. Owners sometimes take some of the cash and put it in their pocket on the way to the bank, or spend it on business expenses like supplies, so the amount getting deposited is less then what the cash register or POS system shows on its reports. An adjustment needs to be made to account for this or the sales reports won't match the bank statements, which are considered source documents and are guaranteed to be asked for by the IRS in an audit.

Customer Deposits

Did you receive any deposits from customers towards work you were going to do later? If these are non-refundable deposits, then they would be counted as income now, but if there is a possibility you would have to refund them, then you would want to make sure that's on the books as a liability. As well, you'd have to track when the work is performed and move that deposit to income, so you can pay the tax on it.

Bank Balances and Reconciliations

If your bank account is connected to QuickBooks, then the bank balance in QuickBooks and your actual bank balance should match except for any transactions which have not yet been excepted into the register for the current period. If this is not the case, there may be transactions which are duplicates or missing transactions.

Check each account in QuickBooks for reconciliations. Reconciling is a specific process where you match the register to your statement. If it's not being done, it's impossible for you to know whether any transactions are missing from your register or if any have been duplicated.

If you have been using the reconciliation features, review the reconciliation history and verify that the beginning balance of this period matches the ending balance of your last period. Are there any changes to the previous reconciliations? There shouldn't be any changes after the reconciliation is complete in order to maintain integrity in the bookkeeping.

In the check register, filter by not-reconciled. You should not see any transactions except for checks that haven't cleared or transactions that occurred in the most recent month.

Liabilities

Sales Tax

If you collect sales tax and are destination-based, meaning that you pay taxes in the city where you perform the work, the sales tax liability report in QuickBooks should match up exactly to the revenue you earn each of those cities so that it can be used to fill out your department of revenue return. This is rarely the case.

QuickBooks has two settings for this, one is their old system where you enter the rates yourself and the new one is where they do the rate for you. Since the rates change from quarter to quarter, and sometimes you need to go back and review older invoices, you can't do this if it's automatically managing the rates for you so as of today, I'm still recommending using the old system, so you can manually identify which quarter the rate was associated with. You do want to ensure if sales tax is being collected, and the tax liability is accruing as a liability on your balance sheet, that when you pay the Department of revenue that liability is going back down.

Vendor Bills

If you are using the vendor bill payment tools in QuickBooks, run the accounts payable report. Does this report only contain current bills? If there are older bills that have already been paid, those expense transaction in the bank register should be matched with the open invoice or the invoice should be deleted.

Equity

Owner's equity is a placeholder top-level category in the chart of accounts and should have two subcategories, owner's contributions and owner's draw. You don't use the top level, just the two subs.

It's not uncommon for small business owners to spend money on their personal cards or accounts and forget to put it on the books for their business as an owner contribution. If you pay for a utility bill on your personal card, this would either go on your company's books as an owner contribution or a loan. Either way, the expense needs to be categorized as utilities. With so much to remember, these types of things are often forgotten. That means you pay income tax on money you could have deducted, and your profits are falsely inflated.

Similarly, business owners often take cash out of the ATM. Was this used to pay contractors, or should it be categorized as an owner's draw?

Do you transfer funds to your personal credit cards from your business account? If the card is being used exclusively for business, then it should be listed in the chart of accounts as a liability, so you can take advantage of the automatic downloading and categorizing of the transactions. Usually the expenses on personal cards are missed entirely, but the owner then transfers payments to the card from the business account. If you bought things on your personal cards which you gave to the business, and then you make payments to those cards from the business, those cards need to be on the books or at the very least, they need to be accounted for as expenses. To your accountant, this could appear to be an owner's draw when it was actually an owner's contribution, when it comes to the tax consequence, that could double the impact.

Enter these transactions by categorizing the expenses into their specific categories and offseting with owners contributions equaling the total. This is done through a journal entry.

Journal Entries

There are several other places were journal entries need to occur such as loans that have principal and interest amortizing. The interest has to be expensed so it doesn't affect the principal balance. As well, any credit cards you're paying interest on need to be journal entried to account for the interest. Often payroll needs a split or journal entry as well to break apart the taxes, tips, wages, 401(k), insurance, bonus, etc.

If you receive payments in cash, ensure the actual amount of the deposit made it into the bank register without any deductions occurring. Owner's sometimes keep part or all of the cash they should be depositing. If you keep the cash as the owner, it should still be recorded as income and then taken out as an owner's draw. If some of it was spent on business expenses, the deposit amount should be adjusted to reflect such.

<u>IRS payments</u>

I commonly see payments to the IRS show up as an expense on a client's profit and loss statement. Keep in mind that only C corporations pay taxes to the IRS, for all other entities the owner pays it personally, The only payment your business should be making to the IRS are payroll taxes. Since B & O taxes are only 1.5%, if I see taxes for the year of more than a few thousand, I usually investigate further. If you're making payments on your last year's taxes due on your 1040, or estimating your personal taxes for this year, that's actually an owners draw.

COGS

Many small business owners struggle when their accountant asks for a year-end inventory of their cost of good sold items. They usually guess because they don't have an answer. The beginning and ending inventory is required on your tax return. If you buy things and then sell them as part of operating, review your cost of goods sold categories and ensure you can account for each of the numbers the IRS might look for in an audit.

Income

One thing I see commonly is when there is a number in the unapplied cash payment income on your profit and loss. This usually happens when you tell QuickBooks that you received a payment before the date of the invoice. To remedy this, be sure any invoices have prepared dates prior to the date you received the payment. Thus, if you received a payment on November 10th, you have to date the invoice Nov 10th or earlier.

When reviewing income, run a profit and loss statement and click on total income, you can review every transaction and verify that it actually was income. If it was not, put it in the right category. Was it a refund for something you purchased? Was it money you put into the business? Was it a loan that needs to be on the books as a liability? The IRS loves it when you claim something as income that wasn't.

If you are using the invoicing features, run an accounts receivable report and look for open invoices that were likely paid but not matched to the bank transactions. It's common to have an open invoice and then when the client pays, the payment is applied to income instead of using the "receive payments" feature in the customer center.

Expenses

Review your vendor list to identify the following:

Are there any vendors who are duplicated with maybe just different spellings? These should be merged.

Sometimes when people aren't paying close attention, or don't know how to use all the features in QuickBooks, they enter customers in as vendors. Unless you are also purchasing goods or services from your customers, this is going to cause confusion and possibly create entries in the wrong column.

For each vendor, are the transactions categorized correctly? For example, is shell categorized as gas?

Using the correctly set up chart of accounts as previously mentioned, you would want to put shell as auto, otherwise you would have to put gas in the other expenses or have gas be a sub category of auto.

Watch for expenses like Fred Meyer and Costco where the category could vary depending on what you bought that day. Basically, your goal is to ensure that all the categories matched with each vendor easily flow onto your tax return in one of the allowable IRS categories.

Run a profit and loss statement. If you have the data and you know how, run it for the last two years by year, so it is easy to compare the things that look off. Do the same thing for this year but look at it by month to try and identify things that should've happened monthly which might be missing. For example, if you only show rent in seven out of the 12 months, it might be incorrectly categorized somewhere. If you made a deposit originally, this should show up on your balance sheet as a current asset.

For each line item of expenses on the P & L, click the number to drill down and see the individual transactions which make up that number. Are there any transactions which are in the wrong category?

Look at any of the big numbers in the P & L to make sure they are correct and qualified deductions according to the IRS. In an audit, they are sure to scrutinize the big deductions first.

Sales Tax liability

If you're a small business in Washington and you collect sales tax, carefully review the taxes paid section of your expenses to verify that it only contains the business and occupation portion of your tax, since the sales tax should have reduce your tax liability and would not show up as an expense. Total all your returns for the year and verify the taxes paid matches the number on your P & L.

Credit Card Processing Fees

Do you accept credit card payments? If so, you should expect to see approximately 2 to 3% showing up as a credit card processing fee, if you had refunds those will often get missed, compare your merchant processor report total refunds to the profit and loss statement to see if those refunds match.

If you have employees

There are three sub groups of people who have employees:

1. Using a payroll service that does not synchronize with QuickBooks
2. Using a payroll service that does synchronize with QuickBooks or having a CPA handle payroll and also making any necessary entries in QuickBooks
3. Doing payroll in house

Depending on which of these you are doing, there are different specific things to check. If things are trying to synchronize, check that there isn't a huge payroll tax liability showing on the books that was actually already paid. It's common to miss making these adjustments.

Verify the amounts claimed for wages, taxes, and tips expenses matches what actually would be considered an allowable expense during an audit with the IRS, which means you have to verify that everything is in the right categories. If your service business is collecting tips, those tips are liabilities until you pay them to the employee. If you're depositing money in the bank which includes tips, and you're paying those tips out through your payroll service, those could be getting counted incorrectly as income or could be missed entirely creating a false liability on your balance sheet.

Some employers collect a portion of the credit card processing fee from the employee to make up for processing tips on credit cards, these need to be adjusted as well against the credit card processing fees. How to manage all the issues around payroll and taxes is too complicated of a topic to fully cover in this guide, but if you contact me, I'd be happy to go into more specifics about what to check in your specific scenario.

After you have checked each item above, here is a final list of things to check in QuickBooks

Point of Sale, CRM, and online merchant reports

If you're using a point of sale system like Square or clover, or if you're using a merchant processor like Stripe or PayPal, download your year to date report and compare the figure they think you brought in, to the one that shows on your profit and loss statement. If they show you the breakdown of taxes, tips, and total income, you should be able to match that up to those same categories on your profit and loss statement and balance sheet.

If you are buying from Amazon, using Paypal to purchase from Ebay, or using other online merchant services, download your year to date reports and compare those to what you see on your Profit and Loss statement. Verify things match because this is exactly what the IRS will do. In summary, bookkeeping is complicated but orderly. If you can follow this guide, even if you don't catch everything, you'll be much more prepared for an audit and your financial reports will much more accurately reflect the realty of your business.

We love working with businesses of all sizes, and we have decades of experience! We offer expert bookkeeping that is accurate and affordable.

Let us offer you a bit of peace. We turn mountains of paperwork into beautiful financial reports. We offer a full array of services including:

Preparing to file back taxes, cleaning up financial records, getting you set up with QuickBooks, reconciling your accounts, helping you through an audit, and much more.

If you have a project, are behind, or otherwise would like to talk, our initial phone consultation is free and can be scheduled directly on our website www.sbk2.co. You can also call today 206 794 3864 so we can immediately begin creating solutions for you.

Russ Shulman

Over 2 decades of tax and finance experience and recognized contributor to City of Shoreline, the SBA, and the WA Small Business Development Center. Through his Urbanspending.com project and his continuous speaking engagements throughout Washington, Russ has proven he is committed to the success of small businesses in our community.